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No. 93-942

In The

Supreme Court of the United States

October Term, 1993

SOCIETY BANK & TRUST,

Petitioner,

vs.

IN RE: BELL & BECKWITH, Debtor,
PATRICK A. McGRAW, Trustee,

Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Sixth Circuit

RESPONDENT'S BRIEF IN OPPOSITION

MARY ANN WHIPPLE
Counsel of Record
LANCE M. KEIFFER
FULLER & HENRY
Attorneys for Respondent
One SeaGate, 17th Floor
P.O. Box 2088
Toledo, Ohio 43603-2088
(419) 247-2500

4502
Lutz Appellate Services, Inc.
(800) 3 APPEAL • (800) 5 APPEAL • (800) BRIEF 21

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QUESTIONS PRESENTED

1. Can the anti-alienation provisions of an Employee Retirement Income Security Act ("ERISA")-qualified profit sharing plan shelter employer contributions which violate the provisions of the plan documents, are fraudulent or preferential?

2. Do this Court's decisions in *Guidry v. Sheet Metal Workers Nat. Pension Fund*, 493 U.S. 365 (1990) and *Patterson v. Shumate*, __ U.S. __, 112 S. Ct. 2242 (1992) permanently shield the original source and character of contributions to ERISA-qualified plans from all scrutiny?

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RESPONDENT'S BRIEF IN OPPOSITION

STATEMENT OF THE CASE

A. Introduction

This is a collection action. Respondent, Patrick A. McGraw, Trustee for the liquidation of the Estate of Bell & Beckwith ("the Trustee"), holds an unsatisfied bankruptcy court judgment against Edward P. Wolfram, Jr. ("Wolfram"), a former Bell & Beckwith

general partner[1]. The $29 million principal amount of the Trustee's judgment resulted from the deficiency of property of the Bell & Beckwith bankruptcy estate to satisfy the claims of creditors in the liquidation proceeding. One of the assets available for execution is Wolfram's interest as a beneficiary in the Bell & Beckwith Profit Sharing Retirement Plan and Trust ("Profit Sharing Plan") held by Petitioner Society Bank & Trust ("the Bank") as trustee. The anti-alienation provision in the Profit Sharing Plan required by the Employee Retirement Income Security Act of 1974 ("ERISA"), Section 206(d)(1), 29 U.S.C. § 1056(d)(1), does not shield the general partners' beneficial interests in the Profit Sharing Plan from execution because any contributions on their behalf violated the specific terms of the Profit Sharing Plan, or were fraudulent or preferential transfers, and were void *ab initio*. The Trustee therefore served writs of execution on the Bank to execute on the Bell & Beckwith general partners' Profit Sharing Plan interests.

The Bank objected to the Trustee's execution efforts. The bankruptcy court granted the Bank's objection without holding the evidentiary hearing requested by the Trustee. The district court reversed and remanded the case to the bankruptcy court for an evidentiary hearing on the nature and source of Bell & Beckwith's contributions to the Profit Sharing Plan on behalf of judgment debtor Wolfram. The Court of Appeals affirmed the district court. The case has been remanded to the bankruptcy court for a hearing and further proceedings. The case is not yet complete and, until an evidentiary hearing is held in the bankruptcy court, the facts regarding the improper contributions to the Profit Sharing Plan have not yet been judicially determined.

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1. Bell & Beckwith's other general partners were also judgment debtors to the Trustee. The Trustee reached settlements with them and now continues his efforts to satisfy the judgment only with respect to Wolfram. Wolfram's theft created the deficiency in property of the Estate of Bell & Beckwith that the Trustee is trying to collect.

B. Facts

On February 10, 1983 Respondent was appointed Trustee for the liquidation of the Estate of Bell & Beckwith pursuant to the Securities Investor Protection Act, as amended, 15 U.S.C. § 78aaa, *et seq.* (R. 30, Exhibit A). Bell & Beckwith was an Ohio Limited Partnership (R. 30, Exhibit C) which conducted a stock brokerage business in Toledo, Ohio. Bell & Beckwith ceased its business on February 5, 1983 by order of the district court when a massive fraud committed by Wolfram, the managing general partner, was uncovered. Over a period of years, Wolfram embezzled approximately $47 million from Bell & Beckwith. Wolfram's actions had effectively rendered Bell & Beckwith profitless and insolvent for a number of years before the fraud was discovered. Mr. Wolfram was sent to federal prison in 1983. *See In Re: Bell & Beckwith, McGraw, Trustee v. Connelly,* 838 F.2d 844, 844-845 (6th Cir. 1988).

On August 22, 1975, but effective as of January 1, 1975, Bell & Beckwith entered into an agreement with Toledo Trust, the Bank's predecessor, to restate the provisions of its Profit Sharing Plan in accordance with the then newly-enacted ERISA. (R. 30, Exhibit C). Under the Profit Sharing Plan, Bell & Beckwith is, by definition, the employer. (R. 30, Exhibit D, page 1). The agreement was subsequently amended four times.

The Profit Sharing Plan was approved by the Internal Revenue Service as a qualified plan under the Internal Revenue Code, the relevant provisions of which, to the extent involved in this case, are substantially identical to those of ERISA. (R. 30, Exhibit I). The Profit Sharing Plan is classifiable as a "Keogh" or "HR-10" plan because the participants included the general partners of Bell & Beckwith and employer contributions to the Plan were calculated based upon the net income of the partnership itself. (R. 30, Article III, Section 3.1). A "Keogh" or "HR-10" plan is a retirement plan

in which contributions on behalf of one or more of the participants are based upon the participant's earnings from self-employment.

In addition to qualifying the Profit Sharing Plan as a "Keogh" or "HR-10" plan, the plan documents set forth the method by which contributions were to be calculated and made. The specific provision of the plan documents in effect when contributions in issue were made states that contributions by Bell & Beckwith were to be made only out of "the Employer's net income from its business . . . [to] be determined in accordance with generally accepted accounting practices and shall be computed before any provisions for contributions under the Profit Sharing Plan for any such year." (R. 30, Exhibit C, page 5). This provision expressly and specifically provides that contributions may be made to the Profit Sharing Plan on behalf of participants, including Bell & Beckwith's general partners, *only if* the partnership had net income for a given contribution period. If Bell & Beckwith did not have any net income for a given contribution period, as the Trustee will establish on remand, then any and all contributions made to the Profit Sharing Plan for that period would be improper. The Trustee can prove on remand that the facade of net income upon which employer contributions to the Profit Sharing Plan were originally predicated was dependent upon Wolfram's efforts to cover up his fraud and generate apparent but nonexistent profits for the brokerage.

In addition to provisions governing the source of contributions to the Profit Sharing Plan, the plan documents also contained an anti-alienation clause as required by ERISA, 29 U.S.C. § 1056(d)(1). The anti-alienation clause in the Profit Sharing Plan states:

> The benefits provided hereunder shall not be subject to alienation, assignment, garnishment, attachment, execution or levy of any kind, and

> any attempt to cause such benefits to be so subjected shall not be recognized, except to such extent as may be required by law.

(R. 38, Exhibit C, page 28).

C. Proceedings Below

The Trustee commenced liquidating property of the Bell & Beckwith bankruptcy estate and satisfying customer and creditor claims in February, 1983. In furtherance of his fiduciary obligations to the defrauded customers and creditors of Bell & Beckwith, the Trustee, among many other activities, also filed a complaint in the bankruptcy court on February 4, 1985. (R. 1). The complaint asserted thirteen claims against sixteen defendants, including Wolfram and seven other general partners in Bell & Beckwith, as well as the Toledo Trust Company, the Bank's predecessor as trustee under the Profit Sharing Plan. (R. 1, ¶¶ 6, 14, 22). Among the causes of action in the complaint were Count I, which sought a judgment against Wolfram and the other general partner defendants for the deficiency in property of the estate to satisfy the claims of brokerage customers and creditors, and Counts III, IV and V, which sought reversal of alleged preferential and fraudulent transfers from Bell & Beckwith to the general partners, including transfers of partnership property into the Profit Sharing Plan on their behalf.

The Trustee moved for summary judgment on Count I of the complaint against the general partner defendants, including Wolfram. (R. 6). A Twenty-Nine Million Dollar ($29,000,000.00) final judgment for the deficiency was entered in favor of the Trustee and against seven of the general partner defendants, including Wolfram, on February 15, 1990. (R. 7, 8, 11, 12).

The Trustee then served writs of execution on the Bank with

respect to each judgment debtor general partner in order to obtain the interest of each in all accounts held by the Bank as trustee of the Profit Sharing Plan. (R. 13-26). The Bank formally objected to the Trustee's efforts to execute upon the general partners' interests in the Profit Sharing Plan. (R. 27). In response, the Trustee requested an evidentiary hearing to establish that invalid contributions had been made to the Profit Sharing Plan. (R. 30, page 8). The requested evidentiary hearing was never held.

Instead, on May 28, 1991 the bankruptcy court issued its final Order sustaining the Bank's Objection. (R. 38; Appendix C to Petition For a Writ of Certiorari). The decision by the bankruptcy court ended the Trustee's proceedings in aid of execution against the general partners to satisfy his $29 million judgment through the Profit Sharing Plan and constituted a final order appealable pursuant to 28 U.S.C. § 158(a).

The Trustee appealed the bankruptcy court's Order to the district court. (R. 39). In an Opinion and Order dated June 3, 1992, the district court reversed the bankruptcy court's decision concerning Wolfram's interest in the assets of the Profit Sharing Plan. (R. 47; Appendix B to Petition For a Writ of Certiorari). Prior to the decision by the district court, the Trustee reached settlements with all of the other general partner judgment debtors except Wolfram. The agreements rendered the Trustee's pending appeal moot as to each of the other settling judgment debtors. (R. 40, page 5; R. 45, pages 2-3). The district court held that the anti-alienation clause contained in the Profit Sharing Plan did not shield any assets which were improperly, fraudulently or preferentially contributed to the Profit Sharing Plan. The district court remanded the case to the bankruptcy court for an evidentiary hearing as previously requested by the Trustee, which has not yet been held.

The Bank then appealed the district court order to the Court of Appeals. Construing the specific terms of the Profit Sharing Plan,

the Court of Appeals affirmed the district court's ruling that invalid contributions to the Profit Sharing Plan are void *ab initio* and are not shielded by the ERISA-mandated anti-alienation clause. (Appendix A to Petition For a Writ of Certiorari).

ARGUMENT — REASONS FOR DENYING THE WRIT

There are no "special and important reasons" for this Court to grant the Bank discretionary review in this case. There is no constitutional question involved. There is no conflict among the circuits requiring resolution by this Court.[2] The Court of Appeals properly applied and distinguished settled case law of this Court to the unique facts of this case and the specific terms of the involved Profit Sharing Plan. This is not a decision that warrants or, given the lack of any record from an evidentiary hearing, is even ripe for discretionary review by this Court.

I.

THE COURT OF APPEALS DID NOT CREATE OR LEGISLATE AN EQUITABLE EXCEPTION TO THE ERISA ANTI-ALIENATION PROVISIONS.

In its petition, the Bank mischaracterizes the Court of Appeals' decision as creating an equitable exception to the ERISA anti-alienation provisions. The Bank's mischaracterization is a necessary predicate to trying to create a conflict with this Court's decisions in both *Guidry v. Sheet Metal Workers Nat. Pension Fund*, 493 U.S. 365 (1990), and *Patterson v. Shumate*, __ U.S. __, 112 S. Ct. 2242 (1992). No such conflict exists.

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2. The only other appellate decision relevant to the facts and issues of this case is *Velis v. Kardanis*, 949 F.2d 78 (3rd Cir. 1991). The Court of Appeals' decision in this case is consistent with *Velis*.

The Court of Appeals explicitly acknowledged and respected the holdings and policies established in *Guidry* and *Patterson*, while distinguishing them from the legal issue and specific facts involved in this case. Neither *Guidry* nor *Patterson* involved any question as to the propriety in the first instance of contributions made to those plans. Where, as here, the contributions either violate the terms of the plan, or are fraudulent or preferential, they are void *ab initio*. Improperly contributed plan assets never become subject to ERISA's anti-alienation provisions or to the principles set forth by this Court in *Guidry* and *Patterson*. The Court of Appeals did not create or legislate any equitable exception to ERISA's anti-alienation provisions, as prohibited by *Guidry* and *Patterson*, because it did not need to do so.

In *Guidry*, a union official and fiduciary of the union's retirement plan was convicted of embezzling union funds. The embezzlement involved only general funds of the union and not the funds or other assets of the union-sponsored plan. The union sought to impose a constructive trust upon the official's interest in the plan. When called upon to decide whether the union could reach the official's interest in the assets of the plan even though protected by an ERISA anti-alienation clause, this Court declined to create an equitable exception for the union official's misconduct and held that the anti-alienation clause barred the union's action.

The Bank argues that, because this Court in *Guidry* declined to allow the union to reach the official's interest under the plan , the Court of Appeals in the present case erred when it held that the Trustee could reach Wolfram's interest in the Bell & Beckwith Profit Sharing Plan. There is a crucial distinction between the facts of *Guidry* and the facts in this case which the Bank ignores. In *Guidry* the creditor did not argue that the fraudulent acts and the interest in the plan were directly related. The propriety in the first instance of contributions to the plan was not an issue in *Guidry*, whereas it is the only issue here. In contrast to what the Trustee will

establish in this case, the assets sought to be reached in *Guidry* were properly contributed to the plan and were therefore unquestionably protected by the anti-alienation clause. The union could not avoid the effect of the protective provision without attempting to invoke and establish an unwritten equitable exception to ERISA's anti-alienation provisions. Here, the Court of Appeals did not make any such equitable exception because the assets the Trustee has executed upon were not properly contributed to the Profit Sharing Plan in the first place.

Patterson involved the Chapter 7 bankruptcy of an individual debtor who sought to exclude from his bankruptcy estate a vested interest in an ERISA-qualified retirement plan. The debtor claimed that the ERISA-mandated anti-alienation clause excluded the interest from his bankruptcy estate as a restriction on transfer of a beneficial interest of a debtor in a trust that is enforceable under applicable nonbankruptcy law, as preserved by the Bankruptcy Code, 11 U.S.C. § 541(c)(2). This Court held that the Bankruptcy Code phrase "applicable nonbankruptcy law" in 11 U.S.C. § 541(c)(2) includes federal law, such as ERISA. Therefore, this Court concluded that the ERISA-mandated anti-alienation clause in the plan in issue in *Patterson* constituted a restriction on transfer of a beneficial interest in a trust enforceable under applicable nonbankruptcy law. As in *Guidry*, in *Patterson* the bankruptcy trustee never asserted that he could reach the debtor's interest in plan assets because they were improperly, fraudulently or preferentially contributed to the plan in the first place.

No equitable exception that conflicts with *Guidry* or *Patterson* was created by the Court of Appeals; hence, neither intervention nor review by this Court is necessary.

II.

THE COURT OF APPEALS' DECISION DOES NOT PLACE ANY NEW OR UNDUE BURDENS ON THE BANK OR ANY OTHER PLAN TRUSTEE.

The facts of this case are unique and involve the specific contribution terms of a particular Profit Sharing Plan. The supposed fears and burdens the Bank hypothesizes as a basis for this Court's discretionary review are not involved in this case. Nothing in the Court of Appeals' decision legislates any burden or duty on plan trustees like the Bank to police and review the nature and source of qualified plan contributions. The decisions below place the burden of establishing the impropriety of contributions to the Profit Sharing Plan squarely on the Trustee. Under the Court of Appeals' decision on the specific facts of this case, neither the Bank nor other plan trustees will be subjected to a potential flood of burdensome and unwanted litigation.

The Bank's protestations against the imposition of a supposedly unwarranted burden of inquiry ignore the burden of fiduciary responsibility already assumed by the Bank as a trustee under ERISA. If, for example, a pension or profit-sharing plan, unbeknownst to the Bank and without fault on its part, were to lose its qualified status under the Internal Revenue Code, the Bank, as trustee, would incur substantially different — and arguably far more burdensome — obligations with respect to the taxability of the trust fund and related matters. Yet the Bank, and other financial institutions that undertake qualified plan trusteeships in return for fees, routinely rely, without extensive independent inquiry, on representations by plan sponsors that such qualified status remains intact. As related to a supposed burden of inquiry on the Bank, there would appear to be no significant difference between the risk of plan disqualification, which the Bank regularly assumes, and any risk that might arise from accepting improper contributions to an otherwise qualified plan.

The Bank's argument for review also proceeds from the unstated assumption that ERISA plans are rife with improper and invalid contributions that will generate litigation. Even if that assumption were true, nothing in the Court of Appeals' decision penalizes the Bank or other similarly situated plan trustees as a result of such a state of affairs. As the Bank concedes at page six of its petition, "... whether the contributions to the Trust [Profit Sharing Plan] should or should not have been made is, with respect to the Bank and its duties or obligations, irrelevant."

Indeed the unproven assumption that ERISA plans are rife with improper and invalid contributions would be more likely to become reality had the Court of Appeals ruled differently in this case. The result sought by the Bank would certainly encourage and tend to validate the use of ERISA-qualified plans as impenetrable safe havens to place improper or fraudulent contributions beyond reach. The protective umbrella of an ERISA anti-alienation clause does not cover and should not cover improper or fraudulent contributions. Nothing in the letter or spirit of ERISA, the prior decisions of this Court in *Guidry* and *Patterson*, or the statutory fiduciary obligations of plan trustees such as the Bank even tends to support such a result.

III.

THE BANK IS ASKING THIS COURT TO EXERCISE DISCRETIONARY REVIEW OF AN INCOMPLETE RECORD.

The Trustee was denied the opportunity for a hearing to present evidence on the nature and invalidity of Bell & Beckwith's contributions to the Profit Sharing Plan. The district court remanded the case to the bankruptcy court to conduct an evidentiary hearing. The Court of Appeals affirmed the district court ruling and remand. Without an evidentiary record, the review

sought by the Bank is almost as hypothetical as the supposed burdens on plan trustees that the Bank attempts to create. This Court's discretionary powers should not be exercised on an undeveloped record arising under a set of unique and specific factual circumstances.

CONCLUSION

For the foregoing reasons, the petition for a writ of certiorari should be denied.

Respectfully submitted,

MARY ANN WHIPPLE
Counsel of Record
LANCE M. KEIFFER
FULLER & HENRY
Attorneys for Respondent
One SeaGate, 17th Floor
P.O. Box 2088
Toledo, Ohio 43603-2088
(419) 247-2500

Of Counsel for Respondent
Patrick A. McGraw, Trustee
for the Liquidation of
Bell & Beckwith:

FULLER & HENRY
One SeaGate, 17th Floor
P.O. Box 2088
Toledo, Ohio 43603-2088